No. 90-1929

In The

Supreme Court of the United States

October Term, 1990

Pennsylvania Power Company,
Petitioner

v.

Pennsylvania Public Utility Commission and
Pennsylvania Office of Consumer Advocate,
Respondents

Petition for Writ of Certiorari to the
Supreme Court of Pennsylvania

BRIEF OF RESPONDENT PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a public utility's decision to purchase power at wholesale from an unaffiliated interstate supplier may be reviewed by a state public utility commission for its reasonableness, prudence, and benefits to retail ratepayers.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent Pennsylvania Office of Consumer Advocate ("Consumer Advocate" or "OCA") respectfully submits this Brief in Opposition to the Petition for Writ of Certiorari filed by the Pennsylvania Power Company ("Penn Power") to review the judgment of the Supreme Court of Pennsylvania in this case.

STATEMENT OF THE CASE

Penn Power is a public utility providing retail electric service in portions of Western Pennsylvania. Penn Power

is a wholly owned subsidiary of Ohio Edison Company ("Ohio Edison"), a public utility providing retail electric service in portions of Eastern Ohio. Penn Power's electric transmission system is an integral part of the Ohio Edison system. The Penn Power/Ohio Edison system is operated as a combined electric system. Neither Penn Power nor Ohio Edison has other affiliates engaged in the generation or sale of electricity. Moreover, neither utility is a member of an integrated power pool with other utilities.

Penn Power's description (Petition for Writ of Certiorari (hereafter "Petition") at 2) of its membership in the Central Area Power Coordination Group ("CAPCO") is not correct. While it is true that Penn Power and Ohio Edison are members of CAPCO, CAPCO is not now (and never was) an "integrated power pool," as Penn Power claims. Petition at 2. CAPCO was created in 1967 as a method by which five utilities (Penn Power, Ohio Edison, Duquesne Light Company, Cleveland Electric Illuminating Company ("Cleveland Electric"), and Toledo Edison Company) would engage in joint planning, construction, and ownership of certain generating plants. *See Cleveland Electric Illuminating Co.*, 20 FERC ¶ 61,159 (1982), at 61,335 n.2 ("CAPCO companies coordinate the construction of base-load generating plants and share in their ownership as tenants in common.") In addition, the CAPCO members agreed to try to assist one another with economic purchases and sales of power, as well as transfers of power during emergencies.

Even at its inception, CAPCO was never an integrated, centrally dispatched power pool. Moreover, in 1980, CAPCO substantially changed its function. At that time, the CAPCO companies agreed that they would no longer engage in joint planning of their systems. From that point

on, CAPCO existed solely to complete construction of certain jointly owned generating plants and to provide limited assistance in times of emergency. Thus, by 1988, the PUC stated: "At the present time, CAPCO does not operate as a power pool or a regional reliability council." *Pa. Public Utility Commission v. Duquesne Light Co.*, 66 Pa. P.U.C. 518, 712 n.2 (1988).

At pages 2 and 3 of its Petition, Penn Power refers to "allocations" and "reallocations" of plant capacity among the CAPCO members. The use of such terms in this context is seriously misleading to the Court. The term "allocation" is a term of art which applies to a purchase ordered by the Federal Energy Regulatory Commission ("FERC"). That term does not apply to the transaction between Penn Power and Cleveland Electric. Some of the CAPCO members independently decided to become joint owners of certain generating plants under construction. Among the plants were units 1 and 2 of the Perry nuclear station, in which Cleveland Electric, Penn Power, Ohio Edison, and Duquesne Light Company agreed to participate.

In 1980, while Perry was under construction, Penn Power and Ohio Edison agreed to sell a portion of their ownership interest in Perry to Cleveland Electric. Through this agreement, Penn Power agreed to sell Cleveland Electric 12 megawatts ("MW") of its 75-MW share of Perry units 1 and 2. In addition, Penn Power agreed to repurchase 12 MW of Perry 1 for the first 18 months after Perry 1 became commercially operable. This was an arms' length transaction between non-affiliated utilities. The agreement between Penn Power/Ohio Edison and Cleveland Electric was never filed with, let alone approved by, FERC. Penn Power expressly concedes this point at page 13 (n.9) of its Petition.

This repurchase of 12 MW of Perry 1 (frequently referred to below as "the Perry buy-back") is the source of the dispute in this case. In December 1987, just after Perry 1 became commercially operable, Cleveland Electric filed a rate with FERC which Cleveland Electric would charge to Penn Power for the Perry buy-back. At roughly the same time, Penn Power asked the Pennsylvania Public Utility Commission ("PUC") to approve a rate increase which would permit Penn Power to recover the costs of the Perry buy-back from its retail customers in Pennsylvania.

As filed with the PUC, Penn Power estimated that the cost of the Perry buy-back would amount to approximately $1 million per month for each of the 18 months of the buy-back period. Penn Power requested the right to automatically collect these costs from its customers through the use of its Energy Cost Rate ("ECR"), which is an automatic rate adjustment mechanism established pursuant to Section 1307(c) of the Pennsylvania Public Utility Code, 66 Pa. Cons. Stat. § 1307(c). By law, the ECR is limited to the recovery of certain costs (primarily fuel and purchased power costs) associated with the production and purchase of electricity. *Id.*

The Consumer Advocate, as the authorized statutory representative of the interests of Penn Power's ratepayers (*see* 71 Pa. Stat. Ann. §§ 309-1, *et seq.* (Purdon's Supp. 1990)), filed a complaint with the PUC which challenged Penn Power's proposed rate increase. In accordance with its authority under Section 1308 of the Public Utility Code, 66 Pa. Cons. Stat. § 1308, the PUC suspended the operation of the proposed rate increase and conducted an investigation into its merits.

After conducting formal evidentiary hearings and receiving briefs from all parties, the PUC concluded that it

was not just and reasonable for Penn Power to pay $1 million per month for 12 MW of power from Cleveland Electric. The PUC's decision is reported as *Pa. Public Utility Commission v. Pa. Power Co.*, 67 Pa.P.U.C. 86, 93 P.U.R. 4th 359 (1988), which is appended to the Petition as Appendix C (App. 24a-35a). The PUC's conclusion was based on two findings, both of which are fully supported by substantial evidence. First, the PUC found that Penn Power did not need to purchase *any* additional capacity or energy in order for Penn Power to provide safe and reliable service to its customers. App. 28a-29a. Second, the PUC found that even if Penn Power had needed to purchase 12 MW of additional power, it had other options available to it which were substantially less expensive than the purchase from Cleveland Electric. App. 29a. Specifically, the PUC stated, based upon the expert testimony of the Consumer Advocate's witness, that Penn Power could have purchased comparable amounts of power at a cost of approximately $100,000 per month, or just *one-tenth* of the cost which it was paying to Cleveland Electric. App. 30a.

As a result of these findings, the PUC permitted Penn Power to recover from retail ratepayers the cost at which Penn Power could have obtained comparable amounts of power, or approximately $100,000 per month. *See* App. 31a and 34a. The PUC also considered whether its adjustment was pre-empted under Federal law. App. 29a. The PUC concluded that its actions were not pre-empted, since it was neither disturbing a FERC-approved rate nor a FERC-ordered purchase. Rather, it was simply finding that a utility had not reasonably exercised its wholesale purchasing options -- selecting a purchase of power which was 10 times more costly than other reasonably available alternatives. *Id.*

Penn Power appealed the PUC's decision to the Commonwealth Court of Pennsylvania. Penn Power's appeal raised two arguments: (1) that the PUC's decision was not supported by substantial evidence, and (2) that the PUC's decision was federally pre-empted. Commonwealth Court rejected both of these arguments and affirmed the PUC's decision. *Pa. Power Co. v. Pa. Public Utility Commission*, 127 Pa. Commw. 97, 561 A.2d 43 (1989), reprinted as Appendix B to the Petition (App. 2a-23a). Specifically, Commonwealth Court found that the PUC's decision was fully supported by the record evidence. App. 15a. In addition, that court held that the PUC appropriately exercised its authority to examine the reasonableness of Penn Power's wholesale purchasing decision. App. 20a-22a.

Commonwealth Court specifically held that a state utility commission has the authority to examine the reasonableness of a utility's decision to purchase power from one source rather than from other sources. App. 19a-20a. The court held that the PUC did *not* disturb a FERC-approved rate and did *not* alter a FERC-required purchase of power. App. 20a. As such, the court found the PUC's actions to be an appropriate exercise of its jurisdiction. *Id.* The Commonwealth Court, therefore, affirmed the PUC's decision. App. 23a.

Penn Power then sought review of the Commonwealth Court's decision in the Supreme Court of Pennsylvania. That court agreed to hear the appeal of Penn Power, but limited its review to the question of federal pre-emption. After the parties submitted briefs and oral argument, the Supreme Court of Pennsylvania affirmed the Commonwealth Court's order in a one-sentence *per curiam* decision. That decision is reported as *Pa. Power Co. v. Pa. Public Utility Commission*, --- Pa. ---, 587 A.2d 312 (1991) and is appended to the Petition as Appendix A (App. 1a).

SUMMARY OF ARGUMENT

This case does not present a conflict between State and Federal interests. The decisions below do not conflict with any order of FERC and are not inconsistent with any rate on file with FERC. The decisions below are fully consistent with prior decisions of this Court, Federal and state appellate courts, as well as FERC.

The PUC merely exercised its right to examine the reasonableness of the wholesale purchasing decision made by Penn Power. The PUC found that Penn Power did not need to purchase *any* of the power which it purchased. The PUC also found that, had any power been needed, Penn Power could have procured it from other sources (which also were selling under FERC-approved rates) at *one-tenth* of the cost.

The PUC's review was appropriately limited to an examination of the alternatives available to Penn Power. The PUC did not alter the FERC-approved rate. Further, FERC never ordered Penn Power to make this purchase. In fact, neither Penn Power nor Cleveland Electric even *filed* their underlying agreement with FERC. Since the PUC did not disturb a FERC-approved rate or allocation order, the PUC's order was not federally pre-empted. The decisions below properly decided this issue and fully and accurately considered the relevant precedents from this Court.

REASONS FOR DENYING THE PETITION

FERC Does Not Have Exclusive Jurisdiction Over All Aspects Of Wholesale Transactions.

Penn Power's argument stems from an incorrect premise: "The court below has attempted to carve out an exception to FERC's exclusive jurisdiction over

transactions involving the interstate sale of electrical power." Petition at 8. In fact, FERC does not have jurisdiction over *all* aspects of interstate power transactions. Rather, FERC's jurisdiction extends only to the setting of rates for interstate sales and determining the allocation of power among affiliated companies engaged in integrated power pools. In this case, the PUC did not change the FERC-approved rate for the sale of power and FERC did not (and could not) order Penn Power to buy this power.

Since the mid-1960's, there has been no question that FERC has the exclusive jurisdiction to set the rates for wholesale sales of electricity. *Federal Power Commission v. Southern California Edison Co.*, 376 U.S. 205 (1964).

Importantly, this Court has held that FERC's jurisdiction over wholesale sales of power is statutory and is not required by the Federal Constitution. Thus, in *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983), the Court held that where FERC found that it did not have jurisdiction over a wholesale sale of power (there involving a wholesale transaction between two rural electric cooperatives), then the states would have jurisdiction over the matter. Specifically, the Court there held that "Congress' purpose in 1935 [in enacting the Federal Power Act] was to fill a regulatory gap, not to perpetuate one." *Id.*, at 384 (footnote omitted). That is, the Federal interest was to ensure that all sales of power would be regulated either by the states or by the Federal government.

Indeed, this is made clear in the "Declaration of Policy" in the Federal Power Act, where Congress stated: "such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a) (reproduced in Appendix D to the

Petition, App. 37a). Thus, the Act itself makes it clear that transactions should not be allowed to fall into a "gap" between Federal and state regulation.

The Court's holding in *Arkansas Electric* is particularly important in the case at bar. Here, the question is whether FERC had jurisdiction to determine the reasonableness of Penn Power's decision to buy a particular quantity of power from Cleveland Electric. For over a decade, FERC consistently has held that it does not have jurisdiction to determine the reasonableness of a wholesale purchaser's decision to buy from a particular seller. *See, e.g., Philadelphia Electric Co.*, 15 FERC ¶ 61,264 (1981); *Southern Company Services, Inc.*, 20 FERC ¶ 61,332 (1982); *Pa. Power and Light Co.*, 23 FERC ¶ 61,006 (1983) (the state commission "has authority to evaluate the prudence of [the purchaser's] purchase in retail rate proceedings", *id.*, at 61,018); *Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984) ("the Commission is not empowered to disapprove or modify a power sales agreement on the grounds that the buyer may not be making the best possible deal ... the question of the prudence of a utility's power purchases is properly an issue in the buying utility's rate case where it seeks to pass the costs of its purchased power on to its ratepayers"; *id.*, at 61,795); *Pacific Power and Light Co.*, 27 FERC ¶ 61,080 (1984); *Southern Company Services, Inc.*, 28 FERC ¶ 61,349 (1984); *Monongahela Power Co.*, 39 FERC ¶ 61,350 (1987); *Doswell Limited Partnership*, 50 FERC ¶ 61,251 (1990) ("The Commission reaffirms its conclusion that the Supreme Court's decisions in *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986), or subsequent cases, do not preclude state regulators from reviewing the prudence of a utility's purchasing decisions."; *Doswell*, at

61,758 n.18); *Commonwealth Atlantic Limited Partnership*, 51 FERC ¶ 61,368 (1990); *Iroquois Gas Transmission System Limited Partnership*, 52 FERC ¶ 61,091 (1990).

Thus, under the principle enunciated in *Arkansas Electric*, since FERC has held that it does not have jurisdiction over this matter, the states must have the jurisdiction to determine the reasonableness of a utility's wholesale purchasing decisions. There must not be a regulatory "gap."

> *The* Pike County *Doctrine, On Which The Lower Court Relied, Accurately Reflects The Delineation Of Authority Between State And Federal Regulators.*

The delineation between Federal and state authority on which FERC has relied has become known as the "*Pike County* doctrine," after the Commonwealth Court of Pennsylvania's decision in *Pike County Light and Power Co. v. Pa. Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983). The courts below appropriately relied on *Pike County* as setting forth the basic rule applicable to this case.

In *Pike County*, the court upheld the PUC's disallowance of the costs of a wholesale purchase (from Orange & Rockland) made by Pike County. The PUC had found that Pike County had other wholesale purchase options available to it which were less costly than the purchase which it chose to make. In affirming the disallowance, the court accurately summarized the line between federal and state authority as follows:

> The FERC focuses on Orange & Rockland to determine whether it is just and reasonable *for that company to charge* a particular rate, but

> makes no determination of whether it is just and reasonable *for Pike to incur* such a rate as an expense. The PUC, on the other hand, has no jurisdiction to analyze Orange & Rockland's cost of service data and makes no determination as to the reasonableness for Orange & Rockland to charge its rates. The PUC focuses on Pike and its cost of service data to determine whether it is reasonable for Pike to incur such costs in light of available alternatives. So while the FERC determines whether it is against the public interest for Orange & Rockland to charge a particular rate in light of its costs, the PUC determines whether it is against the public interest for Pike to pay a particular price in light of its alternatives. The regulatory functions of the FERC and the PUC thus do not overlap, and there is nothing in the federal legislation which preempts the PUC's authority to determine the reasonableness of a utility company's claimed expenses. In fact, we read the Federal Power Act to expressly preserve that important state authority.

Id., 77 Pa. Commw. at 274-75, 465 A.2d at 738 (emphasis in original; footnote omitted).

This important distinction -- that FERC regulates the wholesale rate of the seller and the states regulate the reasonableness of the purchaser's decision -- is fully consistent with FERC's decisions on this issue and has been recognized by several state and Federal courts. *See, e.g., Kansas-Nebraska Natural Gas Co. v. State Corporation Commission*, 4 Kan. App. 2d 674, 610 P.2d 121 (1980); *Commonwealth Electric Co. v. Department of Public Utilities*, 397 Mass. 361, 491 N.E.2d 1035 (1986);

Appeal of Sinclair Machine Products, Inc., 126 N.H. 822, 498 A.2d 696 (1985); *Spence v. Smyth*, 686 P.2d 597 (Wyo. 1984); *Gulf States Utilities Co. v. Alabama Power Co.*, 824 F.2d 1465 (5th Cir. 1987); *Kentucky West Virginia Gas Co. v. Pa. Public Utility Commission*, 837 F.2d 600 (3d Cir. 1988), *cert. denied*, 488 U.S. 941 (1988).

The latter decision, *Kentucky West Virginia*, is perhaps the most pertinent decision to the case at bar. In that case, the utility challenged the constitutionality of a Pennsylvania statute (and a PUC order entered under the authority of that statute) which required the PUC to examine the reasonableness and prudence of gas utilities' wholesale purchasing decisions. Based on its review, the PUC found that the utility had made wholesale purchases of high-cost gas when lower-cost gas was available from other suppliers (all under FERC-approved rates). The U.S. Court of Appeals for the Third Circuit held that such a review was well within the state's authority under the Natural Gas Act and was not pre-empted by that law or by FERC's actions.[1] Specifically, that court held that the review of utilities' wholesale purchasing decisions is "an area exclusively reserved for state regulation." *Id.*, at 602. Further, after a thorough analysis of the relevant statutes and case law, the court concluded: "[W]e perceive significant support for the authority of states to review the prudence of a retailer's gas purchasing decisions." *Id.*, at 608. This Court subsequently denied certiorari. 488 U.S. 941.

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1 This Court has held that the Natural Gas Act and the Federal Power Act "are in all material respects substantially identical" and that decisions interpreting them may be cited interchangeably. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981).

The facts of the instant case cannot be distinguished from those of *Kentucky West Virginia* or the other cases in the *Pike County* line. Here, the PUC found that Penn Power had purchased power which it did not need at all. Further, the PUC found that even if Penn Power had needed to purchase this power, it could have done so from other suppliers (under other FERC-approved wholesale rates) at a substantially lower cost. Just as was the case in *Kentucky West Virginia*, the PUC prohibited the utility from recovering the costs of a high-cost wholesale purchase when lower-cost power was available from other suppliers.

For over ten years, FERC and various Federal and state courts have held that such a determination lies well within the states' authority under the Federal Power Act. The lower courts' decisions in this case are fully consistent with this line of cases and should not be reviewed by this Court.

This Court's Decisions In Nantahala *And* Mississippi Power *Established A Corollary To The* Pike County *Doctrine.*

Penn Power relies quite heavily on this Court's decisions in *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power and Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988). In so doing, Penn Power argues that those decisions effectively abolished the *Pike County* doctrine. *See* Petition at 18-19. This is not correct.

This Court's decisions in *Nantahala* and *Mississippi Power* establish a corollary to the *Pike County* doctrine: Where FERC has ordered the purchasing utility to make a particular purchase, the purchaser no longer has any options available. When this has occurred, the state commissions'

Pike County authority cannot be meaningfully exercised. That is, because the Federal agency has ordered the utility to make a particular purchase, there are no options to be reviewed under a *Pike County* type of analysis.

> Nantahala: *Where FERC Has Ordered A Utility To Make A Purchase, States May Not Find That An Alternative Was Available.*

This corollary was established in *Nantahala*. The Court in that case made it clear that if FERC allocated certain power to a utility (that is, it ordered the utility to pay for a certain amount of power), a state commission could not find that the utility had an alternative to that purchase. *Nantahala*, 476 U.S. at 971-72. Thus, if FERC orders a utility to make a purchase, the states cannot challenge the reasonableness of that purchase.

Importantly, the Court in *Nantahala* distinguished its decision from the *Pike County* line of cases precisely because the utility had been ordered by FERC to make the purchase (and thus had no options). The Court stated:

> [T]he North Carolina Supreme Court erred in relying on cases treating the reasonableness of purchasing from a particular source of, rather than paying a particular price for, FERC-approved power. See *Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n*, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-738 (1983); *Kansas-Nebraska Natural Gas Co. v. State Corporation Comm'n*, 4 Kan. App. 2d 674, 679-680, 610 P.2d 121, 127 (1980). Without deciding this issue, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if

> lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*. The North Carolina Supreme Court apparently felt that Nantahala procured an unreasonably large amount of purchased power in light of the availability of lower-cost entitlement power. But Nantahala's procurement of purchased power is *not* unreasonably large given that Nantahala could not have treated itself as having access to any more low-cost entitlement power than it is eligible to include under FERC's interpretation of what would be a fair allocation.

Nantahala, 476 U.S. at 972-73 (emphasis in original).

In other words, in *Nantahala*, this Court did not dispute the continued validity of the *Pike County* doctrine, but held that states could not find that a reasonable alternative existed to a *FERC-ordered* purchase of power.

Mississippi Power *and* AEP: *When Does FERC Have Jurisdiction To Order A Utility To Make A Purchase?*

After *Nantahala*, the major issue remaining was: When does FERC have the jurisdiction to order a purchaser to make a particular purchase? This question was answered in *Mississippi Power* and was addressed in some detail in Justice Scalia's concurring opinion and Justice Brennan's dissenting opinion (in which Justices Marshall and Blackmun joined).

Mississippi Power made it clear that FERC's jurisdiction over wholesale purchasers was extremely limited. *Mississippi Power* did not abolish the *Pike County* doctrine. Indeed, *Mississippi Power* did not really affect

the *Pike County* doctrine itself. Rather, that case called on the Court to determine when FERC has jurisdiction to order a purchaser to make a particular purchase. The Court held that in the limited situation where the purchaser was a corporate affiliate of the seller and the parties were engaged in an integrated power pool, FERC had jurisdiction over the purchaser (and, thus, could order the purchaser to purchase a particular quantity of power). As Justice Scalia stated in his concurring opinion:

> After today, the battle will no longer be over who has jurisdiction, FERC or the States, to evaluate the prudence of a particular utility's *entering pooling arrangements with affiliated companies* for the sharing of electric generating capacity or the creation and wholesaling of electrical energy. FERC has asserted that jurisdiction and has been vindicated.

Mississippi Power, 487 U.S. at 383 (emphasis added).

Importantly, all of the Justices in *Mississippi Power* appeared to agree about the general applicability of the *Pike County* doctrine. Thus, the dissent began by citing *Pike County* and *Nantahala* for the general limits on FERC's jurisdiction, stating:

> FERC does not, however, have jurisdiction to determine whether it might be imprudent, given other purchasing options, for a retailing utility to *purchase* power at the FERC-approved wholesale rate. The state utility commissions have jurisdiction to determine, for example, that the retail utility does not need the power or could obtain power from other sources at a lower cost. Thus, although a state utility commission cannot decide that a retail utility

> should have bought wholesale power from a given source at other than the FERC-approved wholesale rate, it can decide that the utility should not have bought power from that source at all. In short, the reasonableness of charging a rate as a wholesaler is distinct from the reasonableness of incurring that charge as a purchaser.

Id., 487 U.S. at 385 (citations omitted; emphasis in original).

Where the dissent and majority differed was in their interpretation of the Federal Power Act to allow an exception to this general principle for affiliated power pools. The presence of an affiliated power pool raised two serious concerns. First, since the companies were affiliates, the transactions were not at arms' length, thereby possibly requiring review by a Federal intermediary. Second, the existence of an integrated power pool blurred the normal distinction between buyer and seller. Justice Brennan described this problem as follows:

> Interstate electricity pools, however, present special difficulties for the wholesale/retail division of jurisdiction because the "wholesale" transaction is from the pool to the utilities belonging to the pool, and thus the entities wholesaling the power are the same ones purchasing and retailing the power.

Id., at 386.

This distinction becomes important because FERC's jurisdiction is limited to matters affecting wholesale rates. In a normal transaction (between non-affiliated parties who are not engaged in an integrated power pool), the mere purchase of power does not affect the wholesale *rate* for power. However, when the transaction is not at arms'

length and the parties are pooled (such that today's buyer might become tomorrow's seller and vice versa), the purchase does have a direct effect on the wholesale rate for power. This distinction was sufficient for a majority of the Court to agree with FERC that, under these limited facts, FERC has jurisdiction over the purchaser of power.

Indeed, what Justice Scalia appeared to find most persuasive was FERC's decision in another series of cases. *See id.* at 378-79. While *Mississippi Power* had been working its way through the lower courts, FERC had issued a series of opinions in cases involving affiliates of the American Electric Power (or AEP) system. In those cases, FERC set forth a reasoned basis for its assertion of jurisdiction over wholesale purchasers where the buyer and seller were affiliates involved in an integrated power pool.

Initially, FERC had held that it would not consider the prudence of the purchasing members of AEP when setting rates for the selling member of AEP. *AEP Generating Co.*, 29 FERC ¶ 61,002 (1984); *AEP Generating Co.*, 29 FERC ¶ 61,246 (1984); *AEP Generating Co.*, 32 FERC ¶ 61,364 (1985). However, FERC subsequently concluded that the affiliated relationship of the parties and their integrated pooling arrangement had a direct effect on the reasonableness of the wholesale rates to be charged.

In *AEP Generating Co.*, 36 FERC ¶ 61,226 (1986), FERC began with a reaffirmation of the general principle that it does not have jurisdiction to examine the reasonableness or prudence of the purchaser's purchasing decision when setting rates for the seller, noting that "[u]nder narrow, non-pool circumstances, that view would remain sufficient and dispositive." *Id.*, at 61,550. FERC then explained, as follows, that the existence of an affiliated, integrated power pool presented a different jurisdictional question:

> [W]here, as here, the transaction involves affiliated, jurisdictional utilities, which are members of an integrated, interstate holding company arrangement, performing diverse functions on a coordinated basis, and particularly where differing interpretations are advocated concerning the parties' rights and obligations under the basic system agreements, the relevant issues may not be so readily segregated. Under these circumstances, more complex, interrelated questions arise and, whether one characterizes the questions as related to prudence, interpretation, or cost allocation, they are clearly matters most appropriately resolved by this Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.

Id. FERC made similar statements in a companion order issued for one of the AEP companies the same day, *Kentucky Power Co.*, 36 FERC ¶ 61,227 (1986). *See also AEP Generating Co.*, 38 FERC ¶ 61,243 (1987), *rehearing denied*, 39 FERC ¶ 61,158 (1987).

In rejecting an attempt by the Kentucky Public Service Commission to alter provisions of the FERC-approved AEP agreements, the U.S. Court of Appeals for the Fourth Circuit described as follows the critical jurisdictional distinction that enabled FERC to regulate purchasers in an integrated pool of affiliated companies:

> Another reason the distinction *Pike County* drew between state and federal inquiries does not exist here is that, unlike the wholesale agreement at issue in *Pike County*, the [pooling agreement among the AEP companies] has no distinct "buyer" and "seller" of energy. *Pike*

> *County* had emphasized that FERC considers interstate agreements from the seller's perspective, while state commissions focus upon the in-state buyer. The nature of the [pooling agreement] and the AEP system is such that an affiliated utility could be at one time a receiver or "buyer" and at another time a supplier or "seller" of energy. FERC thus necessarily considered the fairness of the agreement from the perspective of all involved parties.

Appalachian Power Co. v. Public Service Commission, 812 F.2d 898, 904 (4th Cir. 1987).

In short, this Court's decision in *Mississippi Power*, as well as FERC's explication of its jurisdiction in the *AEP* cases, establish the limited jurisdiction of FERC over wholesale purchasers. FERC has such jurisdiction only where the purchaser is affiliated with the seller and they are members of an integrated power pool.

> NOPSI: *A Limitation On FERC's Jurisdiction Over Affiliated Power Pools.*

Subsequently, the Court clarified this matter further. In *New Orleans Public Service, Inc. v. Council of New Orleans*, 491 U.S. 350 (1989), the Court, in an opinion by Justice Scalia, held that the Federal courts should not abstain from deciding a pre-emption challenge to a Louisiana ratemaking order. In determining whether or not abstention was appropriate, the Court was required to decide if a valid claim of pre-emption existed. The Court outlined the actions taken in the state ratemaking proceeding and concluded that a colorable claim of pre-emption had not been presented. Specifically, the Court stated:

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's [the utility] agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences. *Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it.*

Id., at 367 (emphasis added).

Thus, in *NOPSI*, the Court held that, even where there was an integrated pool of affiliated utilities, the states are not foreclosed from examining a utility's prudence in determining how it would meet its need for power.[2]

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[2] In making such an examination, the states cannot disturb FERC-ordered purchases. However, an issue remains as to whether the costs of such purchases must be collected from retail ratepayers, even if the utility had the opportunity to have third parties bear some of the cost of FERC-ordered purchases. This issue is currently before the Court in *New Orleans Public Service, Inc. v. Council of New Orleans*, No. 90-1156, *cert. granted*, 111 S.Ct. 1617 (1991).

FERC's Actions After Mississippi Power, AEP, *and* NOPSI: *Reaffirmation Of* Pike County.

Just one month after its final *AEP* order was issued, FERC issued an order which made it clear that *AEP* did not change the general rule (which is fully consistent with *Pike County*). In *Monongahela Power Co.*, 39 FERC ¶ 61,350 (1987), FERC was again faced, in the context of the seller's rate case, with a challenge to the prudence of a purchaser. FERC declined to rule on the prudence of the purchaser, holding that because the purchaser and seller were not affiliates and were not members of an integrated power pool, "we do not have jurisdiction in this proceeding over the question of whether PEPCO [the purchaser] was prudent in entering into this transaction." *Id.*, at 62,095.

Thus, immediately after its *AEP* decision, FERC made it absolutely clear that in the case of a transaction between unaffiliated companies, it did not have the jurisdiction to consider the prudence of the purchaser when setting the rate for the seller.

Recently, FERC has considered the effect of this Court's decision in *Mississippi Power* (as well as the Third Circuit's decision in *Kentucky West Virginia*) and reached the same conclusion. Specifically, in *Doswell Limited Partnership*, 50 FERC ¶ 61,251 (1990), FERC held:

> Our finding that Doswell's rate is "just and reasonable" in this filing does not preclude this Commission or the Virginia Commission from examining the prudence of Virginia Power's purchase in a subsequent rate case. The Commission reaffirms its conclusion that the Supreme Court's decisions in *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986), or subsequent cases, do not preclude

> state regulators from reviewing the prudence of a utility's purchasing decisions. While *Nantahala* held that "a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable," 476 U.S. at 966, the Court did not decide the issue whether a state agency can inquire into a utility's prudence in choosing to pay the FERC-approved wholesale rate of another supplier. *See also Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (3rd Cir.), *cert. denied*, 109 S.Ct. 365 (1988); *Pike County Light and Power Co. v. Pennsylvania Public Utility Comm'n*, 465 A.2d 735, 737-738 (1983).

Doswell, at 61,758-59 n.18. *Accord Commonwealth Atlantic Limited Partnership*, 51 FERC ¶ 61,368, 62,249 n.84 (1990); *Iroquois Gas Transmission System Limited Partnership*, 52 FERC ¶ 61,091, 61,359 n.63 (1990); *Boston Edison Co.*, 55 FERC ¶ 61,382, 62,168 n.61 (1991).

In short, this Court, the Federal courts, and FERC each have recognized the continued vitality of the *Pike County* doctrine. *Nantahala* and *Mississippi Power* simply recognized FERC's limited jurisdiction over purchasing utilities which are engaged in integrated power pooling arrangements with affiliated companies.

> *This Case Does Not Fall Within The Limited Exception Recognized In* Nantahala *And* Mississippi Power. *It Is Governed By The* Pike County *Doctrine And Was Properly Decided By The Courts Below.*

Given the very clear limitations on FERC's jurisdiction over wholesale purchasers, there is no doubt

that this case was properly decided by the courts below. Penn Power made a purchase from Cleveland Electric. The purchase was made under a FERC-approved rate, but FERC never ordered Penn Power to make the purchase. Indeed, as Penn Power readily admits, its agreement with Cleveland Electric was never even filed with FERC. Petition at 13, n.9.

Further, even if FERC had been requested to rule on the reasonableness of Penn Power's decision to purchase this power from Cleveland Electric, FERC would have declined to do so because it lacked jurisdiction. Penn Power is not affiliated with Cleveland Electric and is not engaged in an integrated power pool with Cleveland Electric. As FERC has held on numerous occasions, under such facts it does not have jurisdiction to consider the reasonableness or prudence of the purchaser's decision to purchase from a particular seller.

The PUC held that Penn Power did not need any of the power that it purchased from Cleveland Electric. Further, the PUC held that even if Penn Power had needed this power, it could have purchased the same amount of power from other wholesale sellers (at their FERC-approved rates) for substantially less than Cleveland Electric was charging. The PUC therefore disallowed the cost in excess of that which Penn Power could have paid for this power.

The courts below properly held that the PUC's determination was not pre-empted by the Federal Power Act. The decisions below properly relied on the *Pike County* doctrine, as interpreted by this Court in *Nantahala*, *Mississippi Power*, and *NOPSI*; other Federal and state courts; and FERC.

Penn Power's Arguments To The Contrary Are Based On An Incorrect Reading Of The Law And A Misinterpretation Of The Facts.

A close reading of Penn Power's Petition discloses the errors which apparently led Penn Power to believe that the courts below erred. For example, on page 10 of its Petition, Penn Power asserts: "Trapping occurs when a utility is required by its filing with FERC to pay a certain wholesale rate for energy, but then is prevented by a state from recovering the full amount of those costs in its retail rates." The critical point here is that the utility must be required *by FERC* to make the purchase. Here, Penn Power was not required by FERC to purchase any power from Cleveland Electric. As noted above, FERC did not have the authority to order Penn Power to purchase power from Cleveland Electric. *See also* Petition at 12, where Penn Power again incorrectly equates the filing of a rate with FERC with a FERC-ordered purchase of power.

Similarly, on page 11 of its Petition, Penn Power notes that, in *Mississippi Power*, the Court held that "the conflicting needs of individual states must be subordinated to the interests of the system as a whole." Penn Power fails to recognize that the "system as a whole" refers to an integrated power pool of affiliated companies. While such a system was present in *Mississippi Power*, it is completely absent in the present case. There is no "system as a whole" of which Penn Power and Cleveland Electric are members. Each is a separate utility, without common ownership or integrated operations, engaged in an arms' length transaction.

Moreover, Pennsylvania does not have a "conflict" with Ohio in this matter. Penn Power's ratepayers simply

should not be required to pay for power which they do not need (especially when equivalent power was available elsewhere for one-tenth of the cost).

Once again, on pages 14-15 of its Petition, Penn Power errs by asserting that this case is "substantially similar to *Nantahala*" because "Penn Power and Cleveland Electric have allocated 12 MW of power between themselves." In *Nantahala*, though, the critical fact was not that the utilities allocated power between themselves, but that FERC allocated power between the utilities. Further, FERC only had the authority to do so because the utilities were affiliates and engaged in an integrated power pooling agreement. Here, FERC never ordered Penn Power to purchase the power from Cleveland Electric and did not even have the jurisdiction to do so.

In short, Penn Power's Petition is premised on an incomplete and inaccurate reading of the relevant case law. The decisions below are fully consistent with the decisions of this Court and FERC. There is no conflict which this Court needs to resolve.

> *There Is No Compelling Reason For The Court To Hold This Matter Pending The Resolution Of* NOPSI.

On pages 20 through 22 of its Petition, Penn Power suggests that the Court might want to hold this case pending the outcome of the *NOPSI* case, *New Orleans Public Service, Inc. v. Council of New Orleans*, No. 90-1156, *cert. granted*, 111 S.Ct. 1617 (1991). It is respectfully submitted that there does not appear to be any compelling reason why the Court should do so.

Obviously, this case and *NOPSI* both present questions concerning the scope of federal pre-emption under the Federal Power Act. The similarity ends there,

however. The question presented in *NOPSI* is the reach of FERC's jurisdiction over members of affiliated, integrated power pools. Simply stated: Where does FERC's jurisdiction over members of the pools end? That is a question which this Court has not addressed previously.

The case at bar does not present such a novel question. As noted above, the issue here is one which FERC and several Federal and state courts have addressed many times over the past decade. The decisions below are fully consistent with the decisions of FERC and the other courts. There does not appear to be any compelling reason to hold this case in abeyance pending the outcome of the very different issue in *NOPSI*.

Further, the Court recently denied a petition for certiorari raising a related issue of federal pre-emption under the Federal Power Act. *Kansas Gas and Electric Co. v. State Corporation Commission*, No. 90-984, *cert. denied*, 59 U.S.L.W. 3837 (June 17, 1991). The state court's decision in that case, as in the case at bar, did not appear to conflict with prior cases, present a novel question of federal pre-emption, or otherwise impinge on Federal authority under the Federal Power Act. *See* Brief of FERC as amicus curiae in that case, which urged the Court to deny the petition for certiorari. The Court should reach the same result in the case at bar.

CONCLUSION

The Pennsylvania Power Company's petition for writ of certiorari should be denied.

Respectfully submitted,

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